Supreme Court, U.S.
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No. 99-___

In The

Supreme Court of the United States

SMS SYSTEMS MAINTENANCE SERVICES, INC.,

Petitioner,

vs.

DIGITAL EQUIPMENT CORPORATION,

Respondent.

On Petition For Writ Of Certiorari To The United States Court Of Appeals For The First Circuit

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED

1. May a claim of monopolization be denied at the summary judgment stage where evidence is offered of power to raise prices and exclude competition by a seller that possesses over 90% of a definable product market, and that has willfully acquired and maintained that power in order to lessen or destroy competition?

2. When a party has offered proof of a policy change, in addition to proof of market imperfections such as lock-in or high information costs, may summary judgment on the issue of monopoly power in a service aftermarket be granted?

3. Are product warranties in service aftermarkets presumptively pro-competitive where, at the summary judgment stage, the record contains plausible supporting evidence and also plausible contrary evidence as to their nature?

LIST OF PARTIES AND RULE 29.1 LIST

The caption of this petition identifies all parties in the lower court. Petitioner SMS Systems Maintenance Corporation has no parent corporation or subsidiaries. Respondent Digital Equipment Corporation is wholly-owned by Compaq Computer Corporation. No other publicly held corporation owns more than 10% of its stock.

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Report of the Subcommittee on Environmental Problems Affecting Small Business, House Permanent Select Committee on Small Business, *Monopolistic Tendencies of Auto Emission Warranty Provisions*, HR 1628, 93rd Cong., 2d Sess. § 30 (1974) 28

U.S. Dept. of Justice and Fed. Trade Comm'n, *Horizontal Merger Guidelines*, §§ 1.0, 1.11 (1997 Am.) 15

Daniel Wall, *Aftermarket Monopoly Five Years After Kodak*, 11 Antitrust 32 (1997)..... 18

OPINIONS BELOW

The opinion of the Court of Appeals is reported at 188 F.3d 11 (1st Cir. 1999). It is reprinted in the appendix ("App.") at 1A-34A. The district court's opinion and order granting DEC's motion for summary judgment is reported at 11 F. Supp. 2d 166 (D. Mass. 1998), and is reprinted at App. 35A-44A. The Court of Appeals' order denying SMS's petition for rehearing is not reported and is reprinted at App. 45A.

JURISDICTION

The Court of Appeals entered judgment on August 19, 1999. It denied a timely petition for rehearing on September 13, 1999. This Court has jurisdiction to review the judgment by writ of certiorari under 28 U.S.C. § 1254(1).

STATUTORY PROVISIONS INVOLVED

The statute involved is 15 U.S.C. § 2. It is set out verbatim at App. 46A.

STATEMENT OF THE CASE

A. The Parties and The Market

This case concerns competition between Digital Equipment Corporation ("DEC"), a multi-billion dollar manufacturer of computer equipment, and SMS Systems

Maintenance Services Corporation ("SMS"), an independent service organization ("ISO"), in the market for servicing Digital computer equipment. App. at 36A. The market for service of DEC equipment is a large and lucrative one for DEC which possesses over 91% of this $2 billion annual market. App. at 37A.[1]

Until the early 1990s, DEC faced little competition for the service of its own computer equipment. SMS, and other national ISOs, such as DecisionOne and Grumman Corporation, however, began to compete for Digital service customers by offering faster response times, lower prices, and higher quality of service. App. at 4A. Up until the early 1990s, DEC, like other computer manufacturers, offered a one-year, optional warranty on its computers. App. at 3A.

B. DEC's Warranty Policies

In 1994, amid the growing number of ISOs, DEC radically altered its service warranty policies on its mid-range computers, or "servers." DEC introduced a new line of servers, the Alphas, with a mandatory, three-year service warranty. App. at 3A. Unlike DEC's prior, one-year optional warranty, this new service warranty forced the customer to pay for a three-year service contract from DEC, regardless of whether it wanted DEC to service that

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[1] In 1998, Compaq acquired DEC, but Compaq still sells DEC equipment, and DEC continues to service that equipment under warranty.

equipment. In 1995, DEC also embedded a similar, mandatory three-year service contract in all purchases of its installed base of VAX computers. App. at 3A.

The investment in DEC's Alpha and VAX servers is extremely high – ranging from $16,000 to more than $45,000. Even more costly, however, are the software applications many customers must purchase to function on DEC's closed operating systems, that is, unique DEC operating systems that are not interchangeable or easily ported onto another brand of computer. App. at 22A-23A. Moreover, although some of the Alphas run on "open" operating systems such as UNIX, customers who have purchased the Alphas to upgrade existing installed base DEC equipment must continue to run customized DEC applications.

C. Lock-In And DEC's Power To Exploit It

SMS presented undisputed evidence – from DEC customers deposed by DEC and DEC's own marketing reports – that DEC customers are locked-in to DEC equipment and DEC service on that equipment for at least three years. Based on large investments in DEC hardware and software applications, coupled with other expenses like re-training personnel, *see* App. at 5A, DEC customers cannot afford to scrap their investments and switch to another brand of computer equipment, nor can they afford to pay twice for service – once to DEC in the form of a mandatory, three-year service warranty, and another time to an independent company in the form of a three-year service contract.

SMS also presented compelling evidence that DEC possessed the market power to exploit its locked-in customers. DEC possesses over 91% of the market for service of DEC equipment, and that DEC can raise prices and exclude competition in this market. App. at 37A. Finally, not a single competitor in the primary equipment market had adopted, or has since imposed, such a restrictive warranty policy. These facts, coupled with internal DEC documents suggesting that DEC hoped to obtain 100% of the service market, create at least an inference to support SMS's claim that DEC was motivated to adopt its restrictive warranty so that its service division could exclude competition.

D. Proceedings Below

1. Summary Judgment in the District Court

On DEC's motion for summary judgment the district court failed to define a relevant market, in any way authorized by law, conclusorily stating instead that:

> Since Digital's warranty policy was prospective and since information about Digital's mandatory three-year warranty has always been available to potential customers in advance, there is no *Kodak*-type lock-in in this case. The relevant market for antitrust purposes is the primary equipment market not the derivative aftermarket for service and maintenance of Digital computers.

App. at 42A (referring to *Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992) ("*Kodak*").

The district court ignored SMS's evidence that Digital's prospective warranty limited the service options available to customers who, like those in *Kodak*, had purchased their equipment prior to Digital's change in warranty policy. App. at 38A-39A. Because it concluded that SMS had failed to establish a relevant aftermarket for service, the district court granted DEC's motion. App. at 43A.

2. The Court of Appeals' Decision

Though ostensibly on other grounds, the First Circuit affirmed the grant of summary judgment. After noting that the relevant market is the mechanism by which to measure a party's market power, *see* App. at 8A, the Court of Appeals nevertheless failed to define a relevant market at all. It discounted evidence of the realities and choices facing consumers, holding instead that testimony from DEC customers, SMS officers, and DEC's own marketing documents was not "enough" to defeat summary judgment. App. at 24A-25A. The Court of Appeals also dismissed SMS's evidence that DEC possessed over 91% of the market for service of its equipment; according to the panel, a manufacturer can be expected to have such a monopoly share of the market for service of its own equipment. App. at 9A.

The Court of Appeals attempted to distinguish *Kodak* from the instant case, noting that the transparency of DEC's policy and the prospective nature of DEC's warranty helped to "take this case out of *Kodak's* precedential orbit." App. at 16A. In doing so, the Court of Appeals joined other circuits in holding that it was Kodak's

"change" in policy that compelled a trial. Despite evidence of a change in policy, the Court of Appeals determined that DEC's new warranty merely acted as a "subtle disincentive" to switch to another brand of computer, rather than the powerful lock-in phenomenon necessary to demonstrate aftermarket monopoly power as described in *Kodak*. App. at 18A.

REASONS FOR GRANTING THE WRIT

Summary of Argument

Numerous decisions of this Court focus on summary judgment standards, *see, e.g., Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 106 S.Ct. 2505, 91 L.Ed.2d 202 (1986), *Celotex Corp. v. Catrett*, 477 U.S. 317, 106 S.Ct. 2548, 91 L.Ed.2d 265 (1986), *Matsushita Electric Industrial Co., Ltd., v. Zenith Radio Corp.*, 475 U.S. 574, 106 S.Ct. 1348, 89 L.Ed.2d 538 (1986), and for good reason: left unchecked, the potential for abuse of this critical process is great. All too frequently, lower courts have found it expedient, if not attractive, to dispose of complex or novel claims through the use of legal presumptions at the summary judgment stage. This practice leads to unconstitutional results that warrant this Court's review. *See* Supreme Court Rule 10.1(a).

This improper short-circuiting of the judicial process led the Court to take up this critical issue again just six years after the trilogy of summary judgment cases cited above. *See Eastman Kodak Co. v. Image Technical Services, Inc.*, 504 U.S. 451, 112 S.Ct. 2072, 119 L.Ed.2d 265 (1992)

("*Kodak*") ("yet another case that concerns the standard for summary judgment in an antitrust controversy"). Ironically, however the lower courts have primarily followed the dissent in *Kodak*. Therefore, for the very reasons this Court granted review in *Kodak*, it must do so again in this case.

On summary judgment, lower courts, including the panel below, have relied on legal presumptions, created *per se* theories of legality, and have chosen the "best" of competing theories when reviewing complex antitrust claims – all in flat contradiction to this Court's clear direction in *Kodak*. For example, in *Kodak*, this Court made clear that despite their complexity, antitrust claims are no different from any other, i.e., on summary judgment, presumptions may not substitute for factual analysis:

> Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law. This Court has preferred to resolve antitrust claims on a case-by-case basis, focusing on the 'particular facts disclosed by the record.'

Kodak, 504 U.S. at 467, 112 S.Ct. at 2082 (citations omitted). By contrast, the Court of Appeals' decision is based on the legal presumption that DEC's product warranty is "pro-competitive" – indeed "*per se*" lawful – and thus exempt from the very fact-based analysis required in complex cases such as this. App. at 3A-4A.

Moreover, the Court clarified that summary judgment is not appropriate when a court determines that one theory is *more* plausible than another, but rather is appropriate *only* when one party has presented *no* evidence to

support an otherwise implausible theory. *Kodak*, 504 U.S. at 468, 112 S.Ct. at 2083 ("*Matsushita* demands only that the nonmoving party's inferences be reasonable in order to reach the jury."). In other words, summary judgment is not a battle between competing theories; summary judgment should be granted only when one theory has no basis in fact or in law. *Ibid.*

This rule of law has been completely undermined by the panel below, which characterized SMS's theory as "offbeat." App. at 4A. Contrary to *Kodak*, the panel dismissed SMS's claims as "less plausible" than DEC's, and, in the process, rejected evidence that DEC customers were locked-in to future DEC purchases, that DEC had 91% of the market for service of DEC equipment, that DEC had the ability to raise prices and exclude competition, and that DEC had willfully acquired and maintained its monopoly in order to capture 100% of the lucrative market for service of DEC equipment – *prima facie* evidence sufficient to survive summary judgment under *any* precedent of this Court.

This Court also made clear in *Kodak* that an analysis of the relevant market is critical to any summary judgment review and that this analysis is the same whether the proposed market is an aftermarket or a primary market. *See Kodak*, 504 U.S. 479, n. 29, 112 S.Ct. 2089 (" . . . [the Court] has not adopted any exception to the usual antitrust analysis, treating derivative aftermarkets as it has every other separate market.") (citations omitted). The First Circuit expressly contravened this rule:

> . . . SMS's single-minded focus on traditional concepts of product market definition oversimplifies the route it must take. Cases involving aftermarkets are *sui generis*.

App. at 8A. Thus, the panel not only disregarded this Court's clear direction, *and* dismissed SMS's *undisputed* evidence of relevant market, but utterly failed itself to define a relevant market that would place in any meaningful context its numerous presumptions, holdings and *dicta*.

In failing to define a relevant market, the panel below conditioned any finding of aftermarket monopoly power on proof of a change in policy, a holding never adopted by this Court, but now widespread among the lower courts. A recent, notable exception is a very perceptive decision by Judge David F. Levi, *Red Lion Medical Safety, Inc. v. Ohmeda, Inc.*, 63 F. Supp. 2d 1218 (E.D. Cal. 1999), commenting on the disjunct in the logic of these widespread decisions. *See especially, id.*, 63 F. Supp. 2d at 1227 (these courts have it "backwards . . . [t]o insist on a showing of a policy change confuses a symptom of market power and a lack of cross elasticity with the underlying condition itself").

Finally, this Court in *Kodak* explicitly rejected Kodak's request for *per se* legality. *Kodak*, 504 U.S. at 466, 112 S.Ct. at 2082 ("Kodak argues that [its] rule would be *per se*, with no opportunity for respondents to rebut the conclusion that market power is lacking in the parts market."). The Court held:

> Thus, contrary to Kodak's assertion, there is no immutable physical law – no 'basic economic

> reality' – insisting that competition in the equipment market cannot coexist with market power in the aftermarkets.

Kodak, 504 U.S. at 466, 471, 112 S.Ct. at 2082, 2084. *See also id.*, 504 U.S. at 478, 112 S.Ct. at 2087 ("Nor are we persuaded by Kodak's contention that it is entitled to a legal presumption on the lack of market power . . . "). The Court of Appeals' determination that warranties are "pro-competitive" incorporates DEC's *per se* rule of legality, and paves the way for *per se* legality which has been condemned by this Court. *Id.*, 504 U.S. at 466, 471, 478, 112 S.Ct. at 2082, 2084, 2087.

Absent a grant of certiorari from this Court, the judicial abuse of summary judgment, apparent in cases like this one, will increase, the governing standards of antitrust law will be left in confusing disarray, and plaintiffs like SMS will be unconstitutionally deprived of their day in court on issues important to our complex, high-tech, service-oriented economy.

I. THE COURT SHOULD GRANT CERTIORARI TO RE-AFFIRM THE APPLICABLE SUMMARY JUDGMENT STANDARDS IN AN IMPORTANT BRANCH OF ANTITRUST LAW

A. The Panel Below Usurped The Jury's Function By Weighing Evidence And Making Presumptions Unjustified By Prevailing Law

The Court of Appeals below granted summary judgment on SMS's monopolization claim despite evidence that DEC possessed over 91% of the market for service of DEC equipment, that DEC had the ability to raise prices

and exclude competition in that market, that DEC's customers were locked-in, and that DEC had both the power and the motive to exploit this lock-in. In reaching this decision, the panel made assumptions and weighed evidence – all in flat contradiction to its well-settled role on summary judgment:

> [c]redibility determinations, the weighing of evidence and the drawing of legitimate inferences from the facts are jury functions, not those of a judge . . . The evidence of the non-movant is to be believed and all justifiable inferences are to be drawn in his favor.

Liberty Lobby, 477 U.S. at 253, 106 S.Ct. at 2513 (citing *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 158-59, 90 S.Ct. 1598, 1608-09, 26 L.Ed.2d 142 (1970) (the judge's function is not himself to weigh the evidence and determine the truth of the matter but to determine whether there is a genuine issue for trial)).

The Court of Appeals presumed that an "insubstantial" number of customers were locked-in, determined that DEC's own customers were not credible, and concluded that marketing documents prepared by DEC, and relied on by its experts, were unreliable. App. at 20A-21A, 28A-29A. Underlying these determinations was the presumption that SMS's claims were "offbeat" or weak, and thus would fail at trial. App. at 4A, 32A. However, as this Court has often confirmed, such presumptions have no place in summary judgment proceedings. *Kodak*, 504 U.S. at 479, 112 S.Ct. at 2082 ("Legal presumptions that rest on formalistic distinctions rather than actual market realities are generally disfavored in antitrust law").

This Court has also made clear that a judge must not look to whether a non-movant has proven the merit of its claims on summary judgment, as the panel below did, but rather if there exists a genuine issue of material fact to be resolved at trial. *Catrett*, 477 U.S. at 323, 106 S.Ct. at 2552. *See also Hunt v. Comartie*, 526 U.S. 541, 119 S.Ct. 1545, 143 L.Ed.2d 731 (1999) (in ruling on a motion for summary judgment, the non-movant's evidence is to be believed and all justifiable inferences are to be drawn in that party's favor). This Court has made clear that the overall strength of a case is not to be resolved by a court on summary judgment, but rather by a jury at trial:

> It may be the allegations will prove false at trial. But on the record before us it would be impossible to reach such conclusions as a matter of law, and it is not our function to speculate as to the ultimate findings of fact.

Fortner Enterprises Inc. v. U.S. Steel Corp., 394 U.S. 495, 505, 89 S.Ct. 1252, 1260, 22 L.Ed.2d 495 (1969) ("*Fortner I*"). *Norfolk Monument Co., Inc. v. Woodlawn Memorial Gardens, Inc.*, 394 U.S. 700, 701, 89 S.Ct. 1391, 1392, 22 L.Ed.2d 658 (1969) (court should express no opinion on strength or weakness of the case, nor can it properly determine whether a business practice is reasonable at the summary judgment stage). Nevertheless, the Court of Appeals assessed the merit of SMS's claims, *see* App. at 4A-5A, 25A-28A, 32A. Contrary to the Court of Appeals' interpretation, the purpose of summary judgment is not to cut litigants off from their right to trial by jury when the judge dislikes the claim, but to ensure that any disputed material issue is resolved by the trier of fact. *Poller v. Columbia Broadcasting System*, 368 U.S. 464, 473, 82 S.Ct.

486, 491, 7 L.Ed.2d 458 (1962) (citing *Sartor v. Arkansas Natural Gas Corp.*, 321 U.S. 620, 627, 64 S.Ct. 724, 728, 88 L.Ed. 967 (1944)).

B. The Panel's Decision Conflicts With *Kodak* And Other Controlling Antitrust Precedent Regarding Summary Judgment Review

As this Court has previously determined, on summary judgment, a court must view the evidence presented through the framework of controlling legal standards – in this case, substantive antitrust law. *Liberty Lobby*, 477 U.S. at 427, 106 S.Ct. at 2509 (substantive underlying law must be examined in order to define which facts are material on summary judgment). *See also State of Nebraska v. States of Wyoming and Colorado*, 507 U.S. 584, 589, 113 S.Ct. 1689, 1694, 123 L.Ed.2d 317 (1993). Substantively, it is clear that "[t]he offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power as distinguished from growth or development as a consequence of a superior product, business acumen, or historic accident." *Kodak*, 504 U.S. at 481 (citing *United States v. Grinnell*, 384 U.S. 563, 570-71, 86 S.Ct. 1698, 1705, 16 L.Ed.2d 778 (1966)).

Equally well-settled is that in determining the first element of a monopolization claim – monopoly power – a court must first consider the relevant market. *See Grinnell*, 384 U.S. at 570-71, 86 S.Ct. at 1704 (possession of monopoly power must be evaluated in the context of a properly defined relevant market). *See International Boxing Club of*

New York, Inc. v. United States, 358 U.S. 242, 249, 79 S.Ct. 245, 249, 3 L.Ed.2d 270 (1959) (question of monopoly power must be evaluated in the context of a properly defined relevant market). In fact, this Court has explicitly recognized that it is *imperative* to first define a relevant market – absent such a definition, there is no way to measure the ability to exclude competition. *Spectrum Sports, Inc. v. McQuillan*, 506 U.S. 447, 456, 113 S.Ct. 884, 890, 122 L.Ed.2d 247 (1993).

1. the Court of Appeals ignored standards governing definition of a relevant product market

Consistent with a long line of Supreme Court precedent, SMS presented *undisputed* evidence that a relevant product market for the service of DEC equipment could be defined. In *Kodak*, for example, this Court held that "[t]he proper market definition . . . can be determined only after a factual inquiry into the 'commercial realities' faced by consumers." *Kodak*, 504 U.S. at 482, 112 S.Ct. at 2090 (citing, *inter alia*, *United States v. E.I. duPont de Nemours & Co.*, 351 U.S. 377, 76 S.Ct. 994, 100 L.Ed. 1264 (1956) ("no more definite rule can be declared than that commodities reasonably interchangeable by consumers for the same purposes make up that 'part of trade or commerce,' monopolization of which may be illegal") and *Brown Shoe Co. v. United States*, 370 U.S. 294, 325, 82 S.Ct. 1502, 8 L.Ed.2d 510 (1962) ("Outer boundaries of a product market are determined by the reasonable interchangeability of use or the cross-elasticity of demand

between the product itself and substitutes for it. . . . [and] within this broad market, submarkets may exist which, in themselves, constitute product markets for antitrust purposes")). Accordingly, SMS presented evidence that DEC consumers have no choice but to use DEC, or another specially trained firm such as SMS, to service their DEC equipment. It is undisputed that parts for DEC equipment are unique, specialized skills are required to repair DEC equipment, and an entire industry has developed solely to service DEC equipment.[2]

Critically, the *Kodak* Court made clear that it "has not adopted any exception to the usual analysis, treating derivative aftermarkets as it has every other separate market." *Kodak*, 504 U.S. at 479, n. 29, 112 S.Ct. at 2089. Thus, SMS defined the relevant aftermarket for service of DEC equipment like it would have any other relevant market – taking into account the choices available to the consumer, and the cross-elasticity of demand between the equipment market and the aftermarket for service.[3]

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[2] When parts or service for one brand of equipment are unique from the consumer's perspective, the relevant market consists of only those companies who offer those parts or services for its equipment. *Kodak*, 504 U.S. at 479, 112 S.Ct. at 2089. And, as this Court has also recognized, "the development of the entire high-technology service industry is evidence of the efficiency of a separate market for service." *Kodak*, 504 U.S. at 462, 112 S.Ct. at 2080. *See also Brown Shoe*, 370 U.S. at 326, 82 S.Ct. at 1524 (specialized vendors is a factor indicating a separate relevant market exists).

[3] SMS also established that the service market for DEC equipment was the proper relevant product market in accordance with the recently promulgated Horizontal Merger Guidelines. *See* U.S. Dept. of Justice and the Fed. Trade Comm'n,

The Court of Appeals ignored this holding *and* SMS's *undisputed* evidence of relevant market, branding SMS's definition "single-minded." App. at 8A. But in doing so, the panel failed to define any relevant market at all, thus providing no context in which to evaluate or understand the panel's presumptions and holdings regarding DEC's ability to raise prices and eliminate competition. *See, e.g., Spectrum Sports*, 506 U.S. at 456, 113 S.Ct. at 890. Contrary to this Court's clear holding, *see Kodak*, 504 U.S. at 479, 112 S.Ct. at 2089, the panel simply noted that "after-markets are *sui generis*":

> . . . for antitrust cases involving derivative markets, courts cannot reflexively resort to traditional product market definition methods, but must look to *other modes* of scrutinizing the existence and measure of market power.

App. at 8A, 12A (emphasis added). Though the panel never described what these "other modes" of scrutiny were, they were quite clearly grounded in a hostility toward aftermarkets, and a presumption that DEC's product warranty was "good." App. at 3A-4A. As noted above, this Court has been exceedingly clear in its rejection of such a presumptive bias on summary judgment. *Supra* at 11.

Horizontal Merger Guidelines, §§ 1.0 and 1.11 (1997 Am.) (this after market is the narrowest market in which DEC can impose a "small but significant" increase in price without losing so many service customers as to make the increase unprofitable).

2. the Court of Appeals overlooked traditional indicia of monopoly power in granting summary judgment

Consistent with its failure to define or even to consider any evidence of relevant market on summary judgment, the Court of Appeals similarly ignored compelling evidence that DEC possessed monopoly power.[4] This Court has long held that market power is defined as the ability to raise prices or reduce output. *Kodak*, 504 U.S. at 464 (citing *duPont*, 351 U.S. at 391, 76 S.Ct. at 1004). Moreover, because monopoly power is often inferred from market share, "market definition generally determines the result of the case." *Id.*, 504 U.S. at 469, 112 S.Ct. at 2084 (citing Robert Pitofsky, *New Definitions of Relevant Market and the Assault on Antitrust*, 90 Colum.L.Rev. 1805, 1806-13 (1990)).

SMS offered undisputed evidence that DEC's share of the market for service of its equipment was over 91%. App. at 8A, 37A. Such a percentage is *prima facie* evidence of monopoly power under *any* standard recognized by this Court. *See, e.g., Kodak*, 504 U.S. at 481, 112 S.Ct. at 2090 (citing *Grinnell*, 384 U.S. at 571, 86 S.Ct. at 1704 (87% share was a monopoly); *American Tobacco Co. v. United*

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[4] Had the First Circuit refused to "define" a relevant market, but nevertheless analyzed DEC's ability to raise price or exclude competitors for service of DEC equipment, its flawed methodology might have been benign. *See, e.g., Kodak*, 504 U.S. at 469-70, n. 15, 112 S.Ct. at 2083-4 ("[w]hether considered in the conceptual category of 'market definition' or 'market power,' the ultimate inquiry is the same – whether competition in the equipment market will significantly restrain power in the service and parts markets.").

States, 328 U.S. 781, 797, 66 S.Ct. 1125, 1133, 90 L.Ed. 1575 (1946) (over two-thirds of the market is a monopoly); *National Collegiate Athletic Ass'n v. Board of Regents of Univ. of Okla.*, 468 U.S. 85, 112, 104 S.Ct. 2948, 2966, 82 L.Ed.2d 70 (1984)).

Nevertheless, improperly weighing SMS's evidence, the Court of Appeals granted summary judgment based in part on the presumption that DEC can somehow be excused for possessing a "natural monopoly" over the service of its own equipment. App. at 9A (citing Daniel Wall, counsel for Kodak before this Court, *Aftermarket Monopoly Five Years After Kodak*, 11 Antitrust 32, 32-33 (1997) (virtually by definition, manufacturers can be expected to have a monopoly share of the market for service of their own product)).

In *Kodak*, the Court explicitly rejected this very presumption:

> The Court has held many times that power gained through some natural and legal advantage such as a patent, copyright, or business acumen, can give rise to liability if 'a seller exploits his dominant position in one market to expand his empire into the next.'

Kodak, 504 U.S. at 479, 112 S.Ct. at 2089 (citations omitted).

SMS's proof of monopoly power did not simply rest on evidence of market share. Contrary to the panel's findings, SMS offered evidence that DEC had the ability to raise prices for service of DEC equipment and to exclude competition. App. at 26A-27A. SMS also established a genuine dispute that, because of high switching

costs, DEC could exercise this monopoly power despite primary market competition. Overstepping its role on summary judgment, the panel below again disregarded this evidence. *Liberty Lobby*, 477 U.S. at 253, 106 S.Ct. at 2513 (judge's function is not to weigh the evidence presented); *Fortner I*, 394 U.S. at 505, 89 S.Ct. at 1260 (court cannot speculate that evidence will prove false at trial). It concluded, for example, that SMS improperly assumed that the primary market *never* exerts pressure on the aftermarket sufficient to check DEC's high market share, or its ability to raise price. App. at 11A. To the contrary, with evidence of lock-in and monopoly power, SMS established, as is sufficient on summary judgment, that the primary market *might not* exert enough pressure to check DEC's dominance over the service market. *See Kodak*, 504 U.S. at 481, 112 S.Ct. at 2090.

In addition, the Court of Appeals improperly weighed SMS's evidence, determining that customer testimony on lock-in was not probative, and that testimony from SMS's own officers was merely "self-serving." App. at 26A-28A. For example, the panel harshly criticized SMS for failing to garner evidence of the "actual behavior of an installed base." App. at 25A. But, the only three customers deposed in this case – chosen by DEC – explicitly *confirmed* that SMS's theory was their reality.[5] Countless other customers whose comments were

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[5] SMS is *not* required on summary judgment to survey every customer in DEC's entire installed base simply to confirm the only consumer evidence presented in the case. *Kodak*, 504 U.S. at 460, 112 S.Ct. at 2078 (court "declined to require respondents to conduct market analysis or to pinpoint specific imperfections in order to withstand summary judgment").

recounted in internal DEC marketing documents also explained the lock-in, and behaved consistently with SMS's claims. Tellingly, DEC never presented a single customer to *disaffirm* SMS's "theory" – it relied solely on presumptions of law to defeat SMS's claims. A legal presumption in favor of summary judgment is inappropriate where, as here, the court simply "preferred" DEC's theory to SMS's. *Kodak*, 504 U.S. at 468, 112 S.Ct. at 2083 (citing *Matsushita Electric*, 475 U.S. at 594-95, 106 S.Ct. at 1360) ("[In *Matsushita*], the Court did not hold that if the moving party enunciates any economic theory supporting its behavior . . . it is entitled to summary judgment.).

Under the Court of Appeals decision, a plaintiff will be left wondering how much evidence is "enough" to survive summary judgment (*i.e.* testimony from five customers, seven customers, ten customers, or more). Moreover, a plaintiff's ability to survive summary judgment on the at least partially factual issues of relevant market and aftermarket monopoly power will be left to the sole discretion of the judge. Such holdings reject this Court's clear teaching in *Kodak*, and its long-line of summary judgment authority.

II. THE COURT SHOULD GRANT CERTIORARI TO RESOLVE A GROWING SPLIT AMONG THE CIRCUITS REGARDING THE EVIDENCE NECESSARY TO ESTABLISH MONOPOLY POWER IN AN AFTERMARKET

The Court of Appeals not only disregarded traditional indicia of relevant market and monopoly power,

but also seriously limited the circumstances under which a party can establish monopoly power in an aftermarket. In *Kodak*, this Court established that a party can prove market power in an aftermarket, sufficient to survive summary judgment, when it offers evidence of market imperfections such as high information or switching costs ("lock-in"). *Kodak*, 504 U.S. at 464-5, 112 S.Ct. at 2081.

As noted above, SMS presented compelling evidence of lock-in to suggest that DEC could exercise monopoly power despite primary market competition. According to the panel below, however, such evidence will not allow for a finding of aftermarket monopoly power unless it is also accompanied by proof of a policy change. See App. at 15A-16A (DEC's *warranty did not reflect a change in policy like the "bait and switch" policy in Kodak* and further helps to take the case out of *Kodak's* precedential orbit) (emphasis added). In other words, unless a manufacturer has implemented a restrictive business policy *after* its initial entry into the market, there can be no finding of monopoly power in an aftermarket. *Ibid.*

This policy change limitation has its roots in Justice Scalia's dissent in *Kodak*. In that dissent, Justice Scalia surmised that, had Kodak announced its restrictive parts policy at the time of its market entry rather than years later, even the majority probably would not have found monopoly power in the face of primary market competition. *Kodak*, 504 U.S. at 492 (J. Scalia, dissenting).

For many lower courts what began as a dissenting suggestion has now become the "critical" factor in the *Kodak* decision. In *PSI Repair Services, Inc. v. Honeywell, Inc.*, 104 F.3d 811 (6th Cir.), *cert. denied*, 520 U.S. 1265

(1997) for example, the Sixth Circuit granted summary judgment on the presumption that "an antitrust plaintiff *cannot succeed* on [an aftermarket] *theory when the defendant has not changed its policy* after locking in some of its customers, and the defendant has been otherwise forthcoming about its pricing structure and service policies." *Id.*, 104 F.3d at 820 (emphasis added).[6] In *Digital Equipment Corp. v. Uniq*, 73 F.3d 756 (7th Cir. 1996), the Seventh Circuit similarly upheld a grant of summary judgment holding that *"[t]he material dispute* that called for a trial [in *Kodak*] *was whether the change in policy* enabled Kodak to extract supra-competitive prices from customers who had already purchased its machines). *Id.*, 73 F.3d at 762 (emphasis added). In *Alcatel USA, Inc. v. DGI Technologies, Inc.*, 166 F.3d 772 (5th Cir. 1999), the Fifth Circuit recently echoed these holdings: "an antitrust plaintiff cannot succeed on a *Kodak*-type theory when the defendant has not changed its policy after locking-in some of its customers. . . . " *Id.*, 166 F.3d at 783.[7] Relying on these

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[6] It is somewhat unclear under both the panel's decision below, and the *PSI Repair* decision whether this policy change is required to establish relevant market or monopoly power. According to the *PSI Repair* court, since the policy of bundling parts and services was "well-known", there could be no relevant aftermarket for parts and service of Honeywell equipment. *PSI Repair*, 104 F.3d at 819-20. The panel below similarly concluded that unless the evidence shows the manufacturer can exert power in the aftermarket without regard for consequences in the foremarket, the aftermarket is not the relevant market. App. at 12A. Either way the policy change requirement makes no sense. *See infra* at 23-24.

[7] *See also Queen City Pizza, Inc. v. Domino's Pizza, Inc.*, 124 F.3d 430, 440 (3rd Cir. 1997), *cert. denied*, ___ U.S. ___, 118 S.Ct. 1385 (1998) (the Kodak case arose out of concerns about a

opinions, the panel below granted of summary judgment, even though there was an issue of fact that DEC changed its policy. App. at 16A (citing *Digital*, 73 F.3d at 763; *Lee v. Life Insurance*, 23 F.3d at 20, and *PSI Repair*, 104 F.3d at 822).

This decision defies both the record evidence below, and controlling antitrust authority. It is grounded on the presumption that a monopolist who engages in misconduct from the very day it enters a market is somehow less deserving of antitrust scrutiny than a monopolist who engages in misconduct at some later date. Such a presumption is improper at the summary judgment stage, particularly when there is an issue of fact as to whether DEC *did* change its policy. *See Kodak*, 504 U.S. at 467, 112 S.Ct. at 2082. Moreover, such a distinction makes no sense – under *either* scenario, a monopolist can lessen or destroy competition. Indeed, the *Kodak* majority recognized the irrelevance of a policy change to a party's ability to raise price or exclude competition. It never once conditioned its market power analysis on a change in policy or on any other manifestation of market power. *Kodak*, 504 U.S. at 471-78, 112 S.Ct. at 2085-88. In fact, it never even referenced this change in policy. *Ibid.*

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unilateral change in Kodak's policies); *Lee v. Life Insurance Corp. of North America*, 23 F.3d 14, 21 (1st Cir.), *cert. denied*, 513 U.S. 964 (1994) ("the *timing* of the 'lock-in' at issue in Kodak *was central to the Supreme Court's decision*. . . . even the Kodak majority probably would have found no 'lock-in' had Kodak announced its parts-service 'tie' at the time of its market entry.") (emphasis added); *Wilson v. Mobil Oil Corp.*, 984 F. Supp. 450, 459 (E.D. La. 1997) (change in policy was critical to the outcome of the *Kodak* case).

The Ninth Circuit has apparently agreed with the *Kodak* majority in rejecting the policy change limitation on market power. *See, e.g., Datagate, Inc. v. Hewlett Packard Co.*, 60 F.3d 1421 (9th Cir. 1995), *cert. denied*, 517 U.S. 1115 (1996) (court never indicated that a policy change was the crucial element of an aftermarket claim; instead *absent* a policy change, the Ninth Circuit determined that Hewlett Packard's conduct could amount to an illegal tie); *Image Technical Services v. Eastman Kodak Co.*, 125 F.3d 1195, 1212 (9th Cir. 1997), *cert. denied*, ___ U.S. ___, 118 S.Ct. 1560 (1998) (after trial on remand, Ninth Circuit never discussed Kodak's policy change as determinative of monopoly power, but instead concluded that high switching and information costs allowed Kodak to lock-in customers and exercise market power in the aftermarket). Moreover, at least one panel in the Sixth Circuit has similarly rejected this requirement. *See Virtual Maintenance, Inc. v. Prime Computer, Inc.*, 11 F.3d 660 (6th Cir. 1993), *cert. denied*, 512 U.S. 1216 (1994) (on remand after *Kodak* case, court upheld finding of market power in a single brand aftermarket despite the lack of a policy change by Prime). Strangely, the *Virtual* case was not even cited by the *PSI Repair* panel from the same circuit.

Thoughtful critique of the policy change requirement can be found at the district court level. In *Red Lion Medical Safety*, Judge Levi recently articulated the flaws inherent in such a requirement:

> The policy change [in *Kodak*] did not create lock-in; instead, the existence of lock-in – high switching costs – made it both possible and economically desirable for Kodak to change its policy and exploit aftermarket consumers. . . .

> Thus, the policy change did not create monopoly power; it was merely persuasive evidence that Kodak had market power in parts and engaged in monopolistic conduct in the aftermarket despite competition in the equipment market.

Red Lion, 63 F. Supp. 2d at 1227 (citing *Kodak*, 504 U.S. at 476-77, 112 S.Ct. at 2087). There, as here, the policy change is simply proof that a party has chosen to exercise its market power by exploiting locked-in customers.

Under the panel's decision below, a party can no longer establish market power in an aftermarket, or even define a relevant market, absent proof of a policy change. In addition, even with a policy change, a party cannot survive summary judgment on market power when it presents evidence of market share exceeding 90%, and the ability to raise price or exclude competition.

Finally, if a party challenges what appears to be a facially competitive policy, it must engage in Herculean efforts to overcome a presumption of legality on summary judgment. Such holdings eviscerate this Court's decision in *Kodak*. *Kodak* has been treated like a "restricted railroad ticket, 'good for this day and train only.' " *County of Washington v. Gunther*, 452 U.S. 161, 183, 101 S.Ct. 2242, 2255, 68 L.Ed.2d 751 (1981) (Rehnquist, J., dissenting) (citing *Smith v. Allwright*, 321 U.S. 649, 669, 64 S.Ct. 757, 768, 88 L.Ed. 987 (1944)).

III. THE COURT SHOULD GRANT CERTIORARI TO ENSURE THAT PREVALENT AND POTENTIALLY HARMFUL BUSINESS PRACTICES ARE NOT EXEMPT FROM ANTITRUST SCRUTINY.

Ironically, had the Court of Appeals objectively reviewed the evidence presented, it would have recognized that, for purposes of summary judgment, DEC *had* changed its policy after a substantial number of customers were locked-in to future purchases of DEC equipment. App. at 15A-16A.[8] Thus, even accepting the panel's policy change requirement, SMS's claims of monopoly power should have survived summary judgment. *Id.* As noted above, however, the panel below chose to ignore this and other evidence in favor of broad-based legal assumptions, the most egregious of which is that all product warranties are presumptively "good" or procompetitive. App. at 3A-4A. Although some, if not many, product warranties might benefit competition, a court cannot presumptively conclude they do – at least not at the summary judgment stage. *See Kodak*, 504 U.S. at 466-67, 112 S.Ct. at 2082.

Moreover, particularly in the antitrust context, this Court has repeatedly cautioned that summary judgment should be used sparingly where motive and intent play leading roles. *See Norfolk Monument Co.*, 394 U.S. at 703,

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[8] The prospective or transparent nature of the warranty is irrelevant to those DEC customers who are already locked-in to DEC equipment and thus have no choice but to accept DEC's restrictive warranty when purchasing new DEC computers. *Every* DEC customer heard from in this case falls into this category.

89 S.Ct. at 1393; *Poller*, 368 U.S. at 464, 82 S.Ct. at 488. In this case, SMS placed DEC's motive for implementing its three-year service warranty squarely at issue. SMS produced compelling evidence that DEC's motive for implementing its restrictive three-year service warranty was a desire to capture 100% of the lucrative market for service of DEC equipment. DEC's internal documents create at least a plausible inference that DEC developed its mandatory, three-year service warranty to give its service division 100% of the market for service of DEC equipment.

Tellingly, not a single computer manufacturer had adopted, or has since imposed, a similar restrictive product warranty. Instead, they have either allowed customers to opt out of their warranty (thus allowing customers to save money), or have allowed customers to use authorized service providers to perform warranty service (thus preserving customer choice). Thus, although DEC claims that it implemented the restrictive warranty in order to stand behind its equipment, and to meet or beat the competition, DEC clearly could have achieved these goals by allowing for consumer options. The *only* thing it would have sacrificed would have been its ability to capture 100% of the market for service for at least three years.[9]

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[9] Oddly, the panel below relies on the case of *Marts v. Xerox, Inc.*, 77 F.3d 1109, 1112 (8th Cir. 1996), which held that as long as a warranty does not limit a consumer's choice of service provider, there is "usually no antitrust problem." App. at 19A. Unlike any other computer warranty, DEC's three-year, mandatory service warranty *does* limit a consumer's choice of service provider. If a customer does not want to use DEC, it must hire another service provider and pay twice for service for

Given SMS's plausible explanation for DEC's conduct, summary judgment was inappropriate. *Hunt*, 526 U.S. ___, 119 S.Ct. at 1552 (summary judgment is not proper when nonmovant's theory is plausible, or when evidence is susceptible of different interpretations or inferences by the trier of fact). A court simply cannot presume on summary judgment that any business practice is *per se* exempt from antitrust scrutiny. *See, e.g., Kodak*, 504 U.S. at 470-71, 112 S.Ct. at 2084. Nor can the fear of deterring what *might be* pro-competitive conduct form the basis for a grant of summary judgment. *Id.*, 504 U.S. at 478, 112 S.Ct. at 2088 (we are not persuaded by the contention that Kodak is entitled to a legal presumption because there is a significant risk of deterring pro-competitive conduct). A product warranty, like the one at issue here, can eliminate competition in exactly the ways the antitrust laws were designed to protect against. *See, e.g., Specialty Equipment Market Association v. Ruckelshaus*, 720 F.2d 124, 128 (D. D.C. 1983) (citing *Monopolistic Tendencies of Auto Emission Warranty Provisions*, Report of the Subcommittee on Environmental Problems Affecting Small Business, House Permanent Select Committee on Small Business, H.R. 1628, 93rd Cong., 2d Sess. 30 (1974) (" . . . warranties are 'anticompetitive and provide the means by which the major vehicle manufacturers can monopolize the automotive aftermarket.' ")).

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at least three years. Every customer asked testified that such a payment severely limited their service options.

CONCLUSION

SMS has not had its day in court because the court below, like many others, has failed to apply the summary judgment procedures mandated by this Court. For that reason, SMS's petition for a writ of certiorari should be granted.

Respectfully submitted,

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Dated: December 10, 1999

United States Court of Appeals
For The First Circuit

No. 99-1009

SMS SYSTEMS MAINTENANCE SERVICES, INC.,

Plaintiff, Appellant,

v.

DIGITAL EQUIPMENT CORPORATION,

Defendant, Appellee.

APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF MASSACHUSETTS

[Hon. Edward F. Harrington, *U.S. District Judge*]

Before
Torruella, *Chief Judge*,

Campbell, *Senior Circuit Judge*,

and Selya, *Circuit Judge*.

Ronald S. Katz, with whom *Anne Fiero*, *Coudert Brothers*, *Ronald F. Kehoe*, and *Warner & Stackpole LLP* were on brief, for appellant.

J. Anthony Downs, with whom *Shepard M. Remis, P.C.*, *Anthony S. Fiotto*, and *Goodwin, Procter & Hoar LLP* were on brief, for appellee.

August 19, 1999

SELYA, *Circuit Judge.*

In a complaint filed in the United States District Court for the District of Massachusetts, SMS Systems Maintenance Services, Inc. (SMS) accused Digital Equipment Corporation (DEC) of violating Section 2 of the Sherman Act, 15 U.S.C. § 2, by integrating three-year warranties with sales of computer systems. SMS, an equipment servicer, asserted that deploying warranties in this manner unfairly constrained consumers' ability to choose their preferred service providers and thereby paved the way for a monopoly in the services aftermarket for DEC computers. The district judge granted summary judgment in DEC's favor. *See SMS v. DEC*, 11 F.Supp.2d 166 (D. Mass. 1998). Although our reasoning does not mirror that of the lower court, we nonetheless affirm.

I

We sketch the facts, viewing them as favorably to SMS as reason and the record will permit. *See Conward v. Cambridge Sch. Comm.*, 171 F.3d 12, 17 (1st Cir. 1999) (articulating summary judgment standard). We furnish additional details as they become relevant to the ensuing analysis.

DEC manufactures an array of hardware, ranging from personal computers (PCs) to mainframes. In the market for mid-range computers, DEC battles other heavyweights (e.g., IBM, Sun Microsystems, and Hewlett-

Packard) for the attention and affection of consumers. In April 1994, DEC introduced its "Alpha" line, consisting largely of mid-range servers. These models were more powerful and more versatile than their predecessors and embodied certain distinctive technological advances. DEC included a three-year warranty as part of the mid-range Alpha package. Although multi-year warranties for PCs had become standard fare in the early 1990s, a three-year warranty in the mid-range server market was uncommon in 1994. One-year warranties were the norm – indeed, DEC itself provided a one-year warranty in respect to its pre-Alpha products and continued to offer one-year warranties in connection with sales of its established "VAX" line of mid-range computers even after it introduced the Alpha models.[1]

DEC's conception of a warranty as an instrument of competition is scarcely original. *See, e.g.*, 3A Phillip E. Areeda & Herbert Hovenkamp, *Antitrust Law*, ¶ 761, at 55 (1996) (referring to warranty protection as a tool of "non-price competition" that has particular importance for firms competing in robust product-differentiated markets for durable equipment). A warranty functions essentially as an insurance policy. *See generally* Thomas J. Holdych and Bruce D. Mann, *The Basis of the Bargain Requirement: A Market and Economic Based Analysis of Express Warranties*, 45 DePaul L. Rev. 781, 794-99 (1996). The customer pays the purchase price and receives not only the purchased product itself but also the manufacturer's promise to repair defects and supply replacement parts without

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[1] In 1995, DEC extended the three-year warranty policy to new versions of the mid-range VAX systems.

extra charge (usually under certain conditions and during a certain interval). Because a warranty is a mechanism through which a consumer can protect himself against the uncertainties inherent in owning a product that likely will require parts and service over time, the product's allure increases as the warranty terms become more generous. This attraction is magnified in some cases because a strong warranty signals a manufacturer's faith in the quality of its product. In theory, then, warranties boost sales (and, ultimately, profits).

Given this general experience, SMS's claim that DEC's warranty is anticompetitive appears odd at first blush. There is, however, a certain offbeat logic to SMS's position. The aftermarket for servicing computers is both dynamic and lucrative. While manufacturers usually seek to service the hardware that they produce, other firms compete with them for this business. Many of these independent service organizations (ISOs) operate nationally or regionally and some specialize in servicing particular brands of equipment. A manufacturer's customers may in fact prefer to use these ISOs for a variety of reasons, including loyalty, convenience, response time, pricing, and perceived quality of service.

Against this backdrop, SMS – an ISO that operates nationally and specializes in servicing DEC equipment – puts a sinister cast on DEC's introduction of "mandatory" warranties (that is, warranties that accompany the product at no extra charge). SMS contends that current users of DEC equipment, known in the industry argot as its "installed base," are effectively "locked-in" to buying DEC computers in the future because of the magnitude of their sunk costs (e.g., outlays related to training

employees to work with DEC systems and to the acquisition of expensive software that is compatible with those systems). This lock-in phenomenon, SMS warns, creates an environment in which a warranty can function as a vehicle for aftermarket monopolization by creating a disincentive for computer purchasers to consult service firms other than the manufacturer itself. In SMS's view, a purchaser who has a warranty will not readily take his service business to an ISO because no consumer wants to pay twice for the same service – and the longer the warranty, the less the opportunity for ISOs to compete. SMS predicts that, if such practices are left unchecked, lost business opportunities will ruin ISOs, eliminate competition, and eventually enable manufacturers to raise aftermarket prices.

II

Before moving to an analysis of SMS's claim, we must put a Trojan horse out to pasture. DEC suggests that this case involves only a "single product," because the challenged three-year warranty is nothing but an "attribute" of the hardware. If this were true, the primary equipment market would constitute the relevant market and DEC's share of it (according to its estimates, at least) would be far below what SMS would need to show a credible threat of monopolization, and, thus, the case would vanish quietly into the night.

The single product defense is customarily invoked to rebut allegations of an illegal tie brought under Section 1 of the Sherman Act (15 U.S.C. § 1). *See, e.g., Jefferson Parish Hosp. Dist. No. 2* v. *Hyde*, 466 U.S. 2, 18-25 (1984). In

the context of SMS's Section 2 monopoly claim, DEC appears to wield the defense in a different manner, i.e., as a means of eliminating the possibility that its warranty has any relevant connection with the services aftermarket. Although we are tempted to dismiss DEC's assertion simply as a matter of common sense, the best indication of its infirmity resides in the record.

The success of a single product defense ordinarily hinges on observations of actual market practices. If evidence shows that there is significant demand for separate components of what is alleged to be a single product and the product is in fact sold in those forms, there is no single product. *See Eastman Kodak Co.* v. *Image Tech. Servs., Inc.*, 504 U.S. 451, 462-63 (1992); 10 Areeda & Hovenkamp, *supra*, ¶ 1744, at 203. Conversely, if all or substantially all competing firms always or almost always (discounting occasional accommodations for customers with special needs) sell two seemingly separate items together, then the two attributes may be treated as components of a single product. *See generally* 10 Areeda & Hovenkamp, *supra*, ¶ 1744, at 197-98.

In mounting its single product defense, DEC relies heavily on the affidavit of Professor Jerry Hausman, a distinguished economist, who explains uncontroversially that warranties are tools used by manufacturers to promote the attractiveness of their products and thus to gain a competitive edge. Using this statement as a springboard, DEC vaults to the conclusion that hardware and warranty are a single product. But DEC leaps without looking. The record is pellucid that, while some other computer manufacturers bundle warranties with their

machines, the practice, especially with regard to mid-range computers, is anything but universal.

Vendors of mid-range computers offer a variety of ancillary packages with their products, including service contracts, warranties of differing lengths, or nothing at all. Indeed, a DEC official, Jane Heaney, affirmed in the course of pretrial discovery that differing service packages are items that customers can (and do) use to differentiate between competing computer brands. In competitive markets, suppliers' offerings generally reflect consumer demand. *See, e.g., Digital Equipment Corp.* v. *Uniq Digital Tech., Inc.*, 73 F.3d 756, 762 (7th Cir. 1996). We therefore conclude – at least for the purpose of summary judgment – that the mid-range computer market treats warranty and equipment as separate products.

III

Having laid to rest DEC's attempt to shortstop the requisite analysis, we turn to the parameters of SMS's burden. To prove a violation of Section 2 of the Sherman Act, the plaintiff must show both that the defendant has monopoly power in a relevant market and that it has maintained or increased that power through anticompetitive conduct. *See United States* v. *Grinnell Corp.*, 384 U.S. 563, 570-71 (1966); *Town of Concord* v. *Boston Edison Co.*, 915 F.2d 17, 21 (1st Cir. 1990); *Olympia Equip. Leasing Co.* v. *Western Union Tel. Co.*, 797 F.2d 370, 373 (7th Cir. 1986). SMS's monopolization hypothesis begins with the proposition that, before all else, we must define the relevant market. Relying on traditional product market definition cases, *see Brown Shoe Co.* v. *United States*, 370 U.S. 294, 325

(1962); *United States* v. *E.I. du Pont de Nemours & Co.*, 351 U.S. 377, 404 (1956), SMS contends that, because DEC's aftermarket products are "unique" and servicing DEC computers requires specialized expertise, the relevant market must be the aftermarket for servicing DEC mid-range servers.

The argument, if successful, would place SMS at a distinct advantage. Market share often serves as a proxy for market power. *See, e.g., Town of Concord*, 915 F.2d at 30; *Grappone, Inc.* v. *Subaru of New Engl., Inc.*, 858 F.2d 792, 797 (1st Cir. 1988). If we were to agree with SMS that the relevant market is DEC's aftermarket for services, then, given that DEC predominates in that market (as evidenced by its large market share), SMS would have traveled far on the road to establishing DEC's monopoly power. But we believe that SMS's single-minded focus on traditional concepts of product market definition oversimplifies the route it must take. Cases involving aftermarkets are *sui generis*.

The purpose of defining a relevant market is to assist in determining whether a firm has market power. *See Israel Travel Advisory Serv., Inc.* v. *Israel Identity Tours, Inc.*, 61 F.3d 1250, 1252-53 (7th Cir. 1995); *see also U.S. Healthcare Inc.* v. *Healthsource, Inc.*, 986 F.2d 589, 598 (1st Cir. 1993) (noting the importance of remembering what antitrust question the court is trying to answer when it engages in market definition). In its most basic iteration, the monopolist's market power consists of having sufficient economic muscle to permit it to raise prices well in excess of competitive levels without inducing customers to turn elsewhere. *See Town of Concord*, 915 F.2d at 31. It

follows inexorably that a traditional product or geographic market definition exercise would be the starting point in an aftermarket case if, but only if, a large market share in such a derivative market invariably translated into (or at least reliably indicated) monopoly power in that market.

This condition does not obtain as a matter of course. Most firms that service their manufactured products can be expected to have a very high percentage of the services aftermarket for those products. *See generally* Daniel Wall, *Aftermarket Monopoly Five Years After Kodak*, 11 Antitrust 32, 32-33 (1997). Virtually by definition, manufacturers possess relative expertise in repairing their own products (an expertise that increases in importance as the good increases in technological complexity) and consumers typically are reluctant to incur the transaction costs associated with locating and hiring alternative service providers.

But the naked fact that a manufacturer has a high percentage of the market for servicing its own products does not mean that it can raise the price of services or parts with impunity in that market. *See* 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 170-71. Reputation is important to a firm that constantly competes for new customers, and a manufacturer's behavior in the aftermarket probably will be scrutinized by customers shopping for the firm's products in the primary market. If the firm has a bad reputation, that will prompt potential customers to go elsewhere. Moreover, such a firm eventually will suffer defections from its installed base as well, for firms concerned with the long term cannot afford to bite the hands that feed them. *See id.* ¶ 1740, at 153; *see*

also Joseph Kattan, *Market Power in the Presence of an Installed Base*, 62 Antitrust L.J. 1, 15-16 (1993); Wall, *supra*, at 33. Under such circumstances, it ordinarily captures the reality of the marketplace to envision a firm's behavior in the aftermarket as having a direct effect on the "cross-elasticity of demand," *du Pont*, 351 U.S. at 400, with respect to its products in the primary market.

Of course, markets do not always function in the manner we have just described. *Kodak* is a case in point. There, a group of ISOs complained that a copy-machine manufacturer which competed with ISOs in servicing its brand of copiers had engaged in exclusionary behavior in its parts and services aftermarket (Kodak had stopped supplying the ISOs with the parts required to service Kodak copy machines, while at the same time entering into pacts with independent parts manufacturers that prohibited them from supplying the ISOs with copier parts). *See Kodak*, 504 U.S. at 455-56. Then, the manufacturer told its customers that they could not purchase parts unless they agreed to use the manufacturer's aftermarket services. *See id.* at 456-58. Coupling evidence of this scheme with evidence that Kodak was charging supracompetitive prices in the aftermarket, the ISOs accused Kodak of improperly expanding its monopoly in the services aftermarket. *See id.*

Kodak countered that, as a matter of law, a manufacturer cannot wield monopoly power in a derivative market because competitive primary markets, by definition, always check aftermarket behavior. The Court granted certiorari to consider the bona fides of this argument. *See id.* at 454-55. Ultimately, it rejected Kodak's contention as a matter of law and affirmed the remand for further

proceedings because data in the record suggested that Kodak might in fact have been exacting monopoly prices in its derivative market and there was no sign that competition in the primary market deterred it from doing so. *See id.* at 477-78.

Kodak, then, stands for the proposition that the foremarket does not always exert sufficient competitive pressure to insulate the aftermarket from monopolistic practices. It does not hold, as SMS entreats, that the foremarket *never* exerts sufficient competitive pressure to keep the aftermarket pristine. And the fact that the primary market at times may fail to discipline a derivative market does not mean that the latter necessarily constitutes the relevant market for antitrust analysis. Rather, a litigant who envisions the aftermarket as the relevant market must advance hard evidence dissociating the competitive situation in the aftermarket from activities occurring in the primary market. *Cf. id.* at 477 (noting that the plaintiff adduced evidence that the defendants were able to – and did – charge supracompetitive prices in the aftermarket). Put another way, a court may conclude that the aftermarket is the relevant market for antitrust analysis only if the evidence supports an inference of monopoly power in the aftermarket that competition in the primary market appears unable to check. *See id.* at 481-82; *see also* 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 170-71.

We summarize succinctly. In any market with some degree of product differentiation, goods of a single brand will enjoy a certain degree of uniqueness. *See* 3A Areeda & Hovenkamp, *supra*, ¶ 761, at 55-56. While that uniqueness may account for a manufacturer having a large market share in the services aftermarket for its own brand,

that fact, without more, does not suffice to establish that the manufacturer enjoys monopoly power in that market. Unless the evidence shows that the manufacturer can exert raw power in the aftermarket without regard for commercial consequences in the foremarket, the aftermarket is not the relevant market. This means that, for antitrust cases involving derivative markets, courts cannot reflexively resort to traditional product market definition methods, but must look to other modes of scrutinizing the existence and measure of market power. As *Kodak* teaches, in aftermarket situations, market power *vel non* must be assessed by weighing the complete package of primary equipment, parts, and services.[2]

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[2] Although SMS lobbies for a different legal standard, the focal point of its consumer exploitation thesis is that DEC is attempting to exploit its installed base and achieve a monopoly (or a near-monopoly market share) in the services aftermarket by imposing a three-year warranty on all hardware purchases. In the last analysis, this theory depends on the proposition that DEC asserts power in the services aftermarket only by forcing matters in the primary computer equipment market, and thus raises questions characteristic of those situations in which monopolists are alleged to have parlayed power from one market into another. *See, e.g., Kodak*, 504 U.S. at 461-62 (discussing tying); *United States v. Griffith*, 334 U.S. 100, 107-08, (1948) (discussing leveraging). This approach, in and of itself, invites us to look at the primary market, and thus tends to confirm our conclusion that, in determining whether DEC enjoys an aftermarket monopoly, we cannot ignore the impact of the foremarket.

IV

We turn next to the question of whether SMS has managed to create a genuine issue of material fact as to DEC's alleged monopoly power. We think it has not.

A

Laboring to dispel the customary expectation that competition in the primary market may serve as a substantial deterrent to anticompetitive behavior in an aftermarket, SMS first asserts that this is a case in which information costs have distorted market behavior. The argument has its genesis in *Kodak*, where the Court suggested that, under some circumstances, the foremarket's inability to obtain needed information about the aftermarket could foil the former's ability to act as a check on the latter. *See Kodak*, 504 U.S. at 473-76. Because this information could be difficult for ordinary copy-machine buyers to obtain, and Kodak apparently treated informed purchasers more favorably than uninformed purchasers (through price and term discrimination), the Court suggested that these facts might explain Kodak's ability to charge supracompetitive prices in the aftermarket without suffering adverse consequences in the foremarket. *See id.* at 473-74.

DEC counters that the purely prospective nature of its warranty policy removes this case from *Kodak*'s sphere of influence. DEC explains that the only customers affected by the warranty policy are those who purchase new DEC mid-range systems; contracts between ISOs and current owners of DEC platforms are unimpaired. Furthermore, purchasers are keenly aware of the warranty

terms. If a customer does not like the warranty, DEC continues, he will shop elsewhere, either for a different brand of computer or for a DEC computer without a warranty. *See, e.g., Digital*, 73 F.3d at 762 (explaining that customers will shop for other brands if a manufacturer does not satisfy their needs).

We agree that both the transparency of DEC's warranty policy to buyers in the primary market and the policy's prospective outlook militate in DEC's favor. Let us begin with transparency. The *Kodak* Court's discussion of information costs stemmed exclusively from the concern that the type of information necessary for allowing the primary market to check anticompetitive behavior in the aftermarket was unavailable to the average copy machine purchaser. *See* 504 U.S. at 473-76. Given the specific means that Kodak had adopted to stifle competition, the information relevant to the primary market would be lifecycle costing, which, the Justices concluded, was difficult to access. *See id.* at 473-74.

The information deficits that concerned the *Kodak* Court are largely absent here. SMS cites the three-year warranty as the instrument of market dominance. But, unlike the precise cost of owning a machine for its useful life (the *Kodak* scenario), the warranty's existence is obvious to any purchaser in the primary market and, therefore, SMS's ruminations about each purchaser's need to engage in lifecycle costing for installed hardware are beside the relevant point.[3] Hence, the only datum that

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[3] In addressing the question of information deficits between a foremarket and an aftermarket, perfect information

bears on alleged anticompetitive activity in the aftermarket is readily available to the foremarket. Given that the primary market's ability to check a firm's behavior in its own aftermarket hinges in substantial part on whether information about the latter is sufficiently reflected in the former, the transparency of DEC's allegedly monopolistic policy represents a salient departure from the *Kodak* scenario. *Accord PSI Repair Serv., Inc.* v. *Honeywell, Inc.*, 104 F.3d 811, 819-20, 822 (6th Cir.) (concluding that the fact that the defendant's policies were "generally known" was a central datum in barring a *Kodak*-type claim), *cert. denied*, 520 U.S. 1265 (1997).

The prospective nature of the warranty further distinguishes this case from *Kodak*. Kodak had entered into agreements that precluded the distribution of Kodak parts to ISOs. *See Kodak*, 504 U.S. at 458. These agreements were tantamount to a retroactive change in the rules because many customers had purchased Kodak machines against a background understanding that they would be able to procure parts from ISOs. Accordingly,

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about the aftermarket is not required. Rather, the focus should be on whether the primary market is in possession of information that sufficiently reveals the anticompetitive tendencies of a manufacturer in its aftermarket. The nature of this information will depend on the product, the plaintiff's theory, and the particular facts. In some cases (like *Kodak*), lifecycle costing may be significant. In others, however, primary market consumers will not need to calculate lifecycle costs to gain an appreciation for what is happening in an aftermarket. Here, SMS points to no aftermarket behavior on DEC's part that would necessitate a foremarket consumer's inquiry into lifecycle costs. And in all events, SMS's theory of the case makes lifecycle costing irrelevant.

this tergiversation detrimentally affected the expectations of those who had already sunk considerable sums of money into the acquisition of Kodak equipment. Such "bait and switch" tactics can be problematic from an antitrust standpoint when they enable exploitation. *See Digital,* 73 F.3d at 763 (concluding that "[t]he material dispute that called for a trial [in *Kodak*] was whether the change in policy enabled Kodak to extract supra-competitive prices from customers who had already purchased its machines"); *Lee* v. *Life Ins. Co. of N. Am.,* 23 F.3d 14, 20 (1st Cir. 1994) (noting that Kodak's policy change jeopardized its customers' ability to protect themselves). Like the easy availability of information, the purely prospective nature of the warranty helps to take this case out of *Kodak's* precedential orbit. *See PSI Repair,* 104 F.3d at 820, 822.

B

Although this constellation of factors undermines SMS's rote reliance on *Kodak,* the scenario would be fully dispositive of SMS's Section 2 claim only if all purchasers in the primary market were free agents. But SMS says that is not the case. It endeavors to draw an analogy between the *Kodak* plaintiffs' need to buy copier parts and the perceived need of those who already own DEC computers to purchase any new hardware from DEC (rather than its competitors). The linchpin of this analogy is SMS's insistence that repeat purchasers of computers are more or less compelled to patronize the manufacturer with whom they originally dealt because of the concomitant investment in, among other things, specialized training and software. As to these "locked-in" firms, SMS asseverates, integrating a three-year warranty into new

computer systems is akin to the "policy change" that the Kodak Court decried because, at the time of the initial purchases, these consumers had no idea that future generations of DEC computers would bear such warranty terms.

This argument has some conceptual footing. In theory, aftermarkets may be insulated from the competitive atmosphere of primary markets if, and to the extent that, current owners of a manufacturer's products find it prohibitively dear to "switch" to another product because of the large investment they have made. *See Kodak*, 504 U.S. at 476. Because of switching costs, these owners might be harmed even if information about anticompetitive behavior is reflected in the primary market (for example, the manufacturer may offer better purchase terms to first-time buyers). Withal, we do not believe that the evidence suffices to create a genuine issue as to whether this theoretical possibility has been realized here.

Even though SMS's lock-in argument relies heavily on *Kodak*, there is an important factual distinction between the two cases in regard to the nature of the alleged switching costs. When the *Kodak* Court spoke of switching costs, it referred specifically to the cost of purchasing new copying equipment. *See Kodak*, 504 U.S. at 476-77. What prompted the Court to suggest that switching would be necessary was Kodak's policy of offering parts only to those customers who also purchased service from it. This meant that if a customer did not turn to Kodak for service, it could not get parts, and its copy machine eventually would be rendered useless.

Here, by contrast, DEC neither withholds parts nor otherwise precludes any hardware purchaser from using another service provider. If a customer prefers to retain an ISO, it does not need to switch to another computer system. Indeed, the record shows not only that customers do continue to hire ISOs to service DEC machines that are under warranty, but that SMS itself bids for (and has procured) such contracts. Thus, the only switching cost at issue is the cost of writing off the portion of the equipment's purchase price that represents the warranty. If the behavior of consumers and ISOs is any indication, the switching cost is not particularly significant. (Although SMS presents some conclusory testimony that this cost is the rough equivalent of the outlays for regular service contracts, it has absolutely no solid evidence to back up the claim – and, indeed, this testimony is at variance with its announced position that the warranty is in actuality a "loss leader" for DEC. *See infra* note 5.) At any rate, SMS has not proffered significantly probative evidence sufficient to create a fact question as to whether this alleged switching cost is material to a large enough segment of DEC's installed base to harm competition.

To sum up, while the warranty at issue here may act, at least in some cases, as a subtle disincentive that inhibits customers from consulting ISOs (because the customer would, by retaining an ISO, in effect write off whatever extra cost the manufacturer had built into the computer's purchase price to permit it to offer the warranty), there is nothing inherently anticompetitive about the warranty. Unlike *Kodak*, this is not a case in which a manufacturer effectively forces consumers to use one, and only one, service outfit. Moreover, nothing in the

record before us (except for conclusory, self-serving testimony by SMS officers, which we need not credit on summary judgment) suggests that the existence of the warranty dissuades a sufficient number of customers who otherwise would have used ISOs' from doing so. Testimony of unbearable switching costs by a mere handful of disaffected customers does not satisfy SMS's burden of showing that consumers are generally worse off as a result of DEC's warranty policy. *See, e.g.*, 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 152-53.

That is essentially what the Eighth Circuit concluded in a post-*Kodak* case when it indicated that, as long as a warranty does not limit a customer's choice of service provider, there is usually no antitrust problem. *See Marts v. Xerox, Inc.*, 77 F.3d 1109, 1112 (8th Cir. 1996); *see also Digital*, 73 F.3d at 761-62 (reaching a similar conclusion with respect to installed operating systems). We agree with this conclusion. Many manufacturers offer the market bundled products that have separable components. Every day, consumers purchase these products because "buyers often find package sales attractive; a seller's decision to offer such packages can merely be an attempt to compete effectively – conduct that is entirely consistent with the Sherman Act." *Jefferson Parish*, 466 U.S. at 12.

Of course, some consumers may not like all the components, but the overall package fits their needs, they are not constrained in looking elsewhere for alternative components, and they will not have to scrap their prior investments just because the new package is not a perfect fit. Given this commonplace, it cannot be that every time some consumer or group of consumers does not like one component of a complex product, the manufacturer will

be exposed to an antitrust claim on the ground that it has circumscribed consumer choice. The antitrust laws do not require manufacturers to customize their offerings to the precise specifications of each and every customer.

At the expense of carting coal to Newcastle, we note a second serious shortcoming that permeates SMS's lock-in argument. Throughout its analysis in this case, SMS assumes that all current DEC customers fall into the locked-in category. This taxonomy does not hold together: being part of an installed base and being locked-in are not synonymous. A lock-in phenomenon must be shown, not assumed. *See Kodak*, 504 U.S. at 476; *see also* 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 152-53. Moreover, in undertaking this inquiry, the nature of the product must be taken fully into account, for that will inform an inquiring court about the degree of effective control the manufacturer may be able to exert over a consumer's purchasing decisions. That is singularly important here, for the evidence required to show that an installed base is locked-in to future purchases of computer systems is quite different from that needed to show that a copy machine owner is locked-in to buying parts for that machine.

It is an article of faith, for antitrust purposes, that unless a substantial number of preexisting customers are locked-in, defections from the manufacturer's installed base, coupled with losses in the foremarket, in all probability will sabotage any effort to exploit the aftermarket. Our review of the instant record affords no reason to believe that an appreciable number of DEC users are, in fact, significantly locked-in to making repeat purchases of DEC mid-range computers. SMS's most direct evidence of

lock-in comes from the testimony of individuals employed by two of DEC's customers. These individuals – none of whom bore the ultimate responsibility for making decisions regarding new computer purchases and none of whom exhibited any specific or detailed knowledge of how management might go about calculating switching costs – testified generally that once a company has committed to a certain brand of hardware and has acquired ancillary software (including an operating system), it would be costly to migrate to another platform. Significantly, however, the testimony fails properly to account for the nature of a company's decision to purchase new computer hardware and, therefore, we cannot put much stock in it.

The evidence to which we have just referred assumes that a company's decision to replace its computer system will be dictated solely by the hardware that it currently uses. Under certain circumstances, the assumption might hold. The best example probably derives from the analogy that *Kodak* offers. Although the owner of a copy machine might hope that he will not require parts during the machine's useful life, the hope defies reality. When the moment of need occurs, the corporate decisionmaker must be able to purchase a Kodak part – or else, scrap the machine. The fragility of the equipment forces the owner to buy parts, and this need, linked with owners' general unwillingness to sacrifice the remaining useful life of machinery, enables the manufacturer to control and exploit the situation.[4]

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[4] This schema will not be true for every copier owner. If, for example, the remaining useful life of the copier is short enough

The record evidence shows that decisionmaking surrounding the purchase of a new mid-range computer, however, is qualitatively different from the decision to buy copier parts. Typically, a much wider variety of factors will enter into the computer user's decision. Although we do not discount the impact of a server's speed and power (which will lead to hardware upgrades), the record indicates that the availability of software applications designed to meet current or anticipated business needs usually is the determinative factor in this calculus.

This reality is largely borne out by a marketing survey and report that SMS considers to be one of the most significant pieces of documentary evidence in this case. The report's observations are particularly noteworthy because many of the survey respondents were chosen from DEC's installed base and the purpose of the study was to gauge their receptivity to DEC's Alpha and VAX computers. The survey concludes that end users do not focus principally on hardware when making decisions about buying new systems. Rather, in the words of the report, "applications drive the choice of platforms," because software applications represent the business solutions to the problems confronting the computer user.

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that scrapping the machine rather than submitting to supracompetitive aftermarket prices becomes a viable option, there is no lock-in with respect to that customer. Where relevant, the percentage of installed base customers who have old machines as opposed to those who have purchased more recently may be important to determining whether there is a substantial lock-in. We need not pursue the matter here.

There is no record evidence that contradicts, or even comes close to undercutting, this telling point.

A fortiori, if software is the primary determinant in commercial decisionmaking on computer system purchases, the power of affecting a customer's purchasing decisions resides more with those who design and sell software than with hardware manufacturers. That is exactly what the survey indicates. To complicate matters further, software companies tend to develop their applications so that they can be used with the more popular operating systems. In turn, given the efficiencies of networks, many consumers tend to opt for software that is usable on such systems. The evidence in this case shows that operating systems other than DEC's VMS – such as Windows NT and UNIX – are becoming increasingly prevalent (which perhaps explains why DEC engineered the new Alpha line to operate with all three) and many other hardware manufacturers make systems that can accommodate these other operating systems. If DEC is to remain the company of choice for its installed base, it cannot rest on its laurels.

The complex nature of the decision to purchase a new computer system means that an analysis of switching costs in this context cannot parrot the linear inquiry that proved possible in *Kodak*. Here, the cost of shifting to another system must take into account the efficiency gains of buying new software – gains that often may dwarf hardware price in dollar terms. This is true even if one considers the switching costs that are associated with retraining employees and discarding software designed to run exclusively on a particular platform. The record demonstrates convincingly that, in this industry, both

software vendors and hardware manufacturers offer migration support for new customers in the form of significant discounts on training, installation, and software conversion, thus internalizing much of the switching costs.

The impressions that we have gathered from the marketing survey are largely confirmed by the very witnesses on whose testimony SMS relies. Quite aside from the statements these witnesses make about the magnitude of the cost of randomly switching from one currently functioning computer system to another – testimony which, as is clear from our discussion, addresses an irrelevant scenario – all of them acknowledge that, all things considered, if a new computer system would bring more benefits, there would be no objection to the switch. The actual behavior of these witnesses' employers illustrates the point: their firms were in fact in the process of switching some of their systems to other platforms, citing the sorts of reasons we have catalogued.

In fine, the record does not support the conclusion that a substantial number of installed base customers are locked-in – and SMS has failed to make the case. The power of software vendors, the rapid progress of software solutions, the unpredictability of when consumers will seek to purchase a brand new system, the ready willingness of competitors to absorb migration costs, and the uncertain calculus of cost versus efficiency gains that obtains when a firm moves to new applications all distinguish the computer purchase context from the copier context. This plethora of factors strongly implies that, in most instances, DEC has no effective control over

whether a customer will remain loyal when opting to purchase a new computer system.

To address these issues, which are central to assessing the existence of a lock-in, SMS ought to have focused on proof of the actual behavior of an installed base in terms of such consumers' tendency to return to the same manufacturer. It did not marshal any such proofs. Consequently, the record lacks the empirical evidence required to give us a proper glimpse into whether members of an installed base actually behave in conformity with SMS's switching cost hypothesis. Although we do not doubt that some customers may experience the lock-in that SMS envisions, the record affords no reason to believe that such customers are numerous or that they are representative of the installed base. And – in marked contrast to *Kodak* – there is no evidence, direct or circumstantial, that DEC has attempted to locate or exploit vulnerable customers within its installed base (or that it has the capacity to identify and isolate such customers).

These last points are particularly important. In a product-differentiated market (such as the mid-range computer hardware market), there always will be a subset of customers whose subjective preferences, given their specific business needs, will align them more closely with one manufacturer. As we remarked in a closely related context, however, this kind of preference does not translate into the kind of economic power that antitrust law aims to mitigate. *See Grappone*, 858 F.2d at 797 ("Of course, virtually every seller of a branded product has some customers who especially prefer its product. But to permit that fact alone to show market power is to condemn ties that are bound to be harmless, including some

that may serve some useful social purpose."). Sophisticated consumers with such preferences will know beforehand that they will lock themselves in by their choice of manufacturer and do so willingly. What would be of concern is if a firm were able to extend its control by improper means over a sufficiently sizable number of customers who did not have such a preference. The facts at hand do not fit this model. The evidence, taken most favorably to SMS, does not demonstrate a lock-in, certainly not one that raises antitrust concerns. *See* 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 152-53.

C

Because this case arises on an appeal from the entry of summary judgment, it behooves us to stress further SMS's failures at the empirical level.

Here, unlike in *Kodak*, the record is devoid of any evidence of supracompetitive prices or other oppressive terms of business in the aftermarket.[5] Here, unlike in *Kodak*, the record furnishes no reason to believe that new customers are irrelevant to DEC; to the contrary the record shows unequivocally that DEC intended to sell

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[5] For example, there is no evidence that DEC has displayed a pattern of raising service and parts prices in the aftermarket, nor is there evidence that the price of the warranty itself represented a means of extracting monopoly profits. Indeed, SMS has taken the position that the price of the warranty – whatever it may be – actually represents a loss to DEC compared to what it would have gained had it kept its one-year warranties and charged for service during the second and third years.

Alpha computers vigorously to new as well as old customers in an effort to grow its market share.[6] Here, unlike in *Kodak*, there is also no proof indicating that DEC has attempted to discriminate between customers who are knowledgeable and those who are not, or that it discriminates in price (or in offering different warranty terms) between new and repeat purchasers.[7] Such discrimination, the Court explained, would be one way that manufacturers would attempt to prevent sophisticated purchasers from disciplining the aftermarket through their decision to forego buying from the manufacturer. *See Kodak*, 504 U.S. at 475. Moreover, data such as these – that new customers remain important to DEC and that the warranties offered to new and installed base customers have exactly the same terms – are further signs of the absence of aftermarket exploitation. *See* 10 Areeda & Hovenkamp, *supra*, ¶ 1740, at 159.

All of these factors were crucial to the *Kodak* Court's conclusions, forming the bases for the Court's attempts to

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[6] In this regard, SMS points to evidence that DEC was not depending on its VAX models to grow market share. This evidence, however, is not damaging. Because Alpha and VAX both compete for the DEC installed base, one would expect that the terms governing the sale of VAX computers must be comparable to those of Alpha models. And if Alpha computers are competitive with computers in the mid-range computer market generally, then a transitive logic compels the conclusion that VAX terms are disciplined by the mid-range market. SMS has adduced no proof to suggest that matters are any different.

[7] We do not mean to suggest that price discrimination is always a sign of anticompetitive behavior. It is not. *See, e.g., Monahan's Marine, Inc.* v. *Boston Whaler, Inc.*, 866 F.2d 525, 527-28 (1st Cir. 1989).

explain, through hypotheses involving information deficits and switching costs, the possible causes of the market's apparently irregular behavior. *See id.* at 473-78. DEC's alleged behavior, however, is worlds apart from Kodak's. In the absence of comparably suspicious practices, there is no reason to assume that DEC's interest in maintaining its position in a fiercely competitive primary market is not checking any exploitative tendencies in the derivative market.

Represented by able counsel, SMS strives resourcefully to fill these evidentiary gaps. When queried at oral argument, it referred us to the affidavit of Joseph Scordino (SMS's director of marketing). That affidavit does not remedy the empirical shortcomings that we have identified. The closest it comes is the following: "It has been my experience that when [DEC] does not face competition, its prices tend to be higher. For example, [DEC] does not discount its maintenance services on the Alpha 8000s. Thus, the elimination of competition from SMS and other Independent Service Organizations, should result in price increases to customers." We fail to see how we can allow this self-serving speculation to pass for competent evidence. The third sentence is conclusory conjecture of a kind that begs the very question at issue, namely, whether the foremarket sufficiently disciplines the aftermarket. The same is true for the first sentence, because, if competition in the foremarket checks activity in the aftermarket, the absence of competitors in the aftermarket will not lead to higher prices. The second sentence, which deals with Alpha 8000s, is irrelevant; those computers are high-end servers and belong to a different product market (and the record is bereft of evidence that the market

structure for high-end servers has any bearing, direct or by reasoned analogy, on the market structure for mid-range servers).

SMS also cites the report of its retained expert, Dr. William Bleuel, to the effect that DEC has a much greater share of the services aftermarket than it should enjoy, given low customer satisfaction. If DEC did not have monopoly power, this argument runs, it would not have been able to keep its large share of the aftermarket in spite of rampant dissatisfaction. Expert opinions, however, are no better than the data and methodology that undergird them – and, on this score, Dr. Bleuel's conclusions are highly suspect. Although we find Dr. Bleuel's report deficient on several levels, it suffices to discuss only the shortcomings of his data collection.

Dr. Bleuel did not conduct a customer satisfaction survey, but based his opinion on his interpretation of certain internal DEC documents. The relevant part of his report begins with the intuitively obvious proposition that when customer satisfaction declines, chances are that a company will lose some business. Then, citing to sources which it neither attaches nor discusses, the report concludes that DEC's customer satisfaction ratings have been declining. Dr. Bleuel's conclusion may or may not be correct, but an expert must vouchsafe the reliability of the data on which he relies and explain how the cumulation of that data was consistent with standards of the expert's profession. *See Wessmann* v. *Gittens*, 160 F.3d 790, 804-05 (1st Cir. 1998); *see also Kumho Tire Co.* v. *Carmichael*, 119 S. Ct. 1167, 1176 (1999) (directing courts "to make certain that an expert, whether basing testimony upon professional studies or personal experience, employs in the

courtroom the same level of intellectual rigor that characterizes the practice of an expert in the relevant field").

Not only did Dr. Bleuel fail to discuss in his report the nature of the data and its meaning, but he failed to explain whether the information-gathering technique used in the DEC documents was valid, whether the data was sufficiently representative to permit him to draw any relevant conclusions, and whether the sampling methodology used to compile these documents corresponded to methods that might be considered legitimate in his discipline. Expert testimony that offers only a bare conclusion is insufficient to prove the expert's point. *See Mid-State Fertilizer Co.* v. *Exchange Nat'l Bank*, 877 F.2d 1333, 1339 (7th Cir. 1989) ("An expert who supplies nothing but a bottom line supplies nothing of value to the judicial process.").

V

We add a coda. When a party brings a Section 2 claim, it is not enough simply to show that there is monopoly power. Monopoly power may be obtained through legitimate means. An antitrust problem arises only when an improper use of that power, to the detriment of the forces of competition, occurs. Thus, to make out a Section 2 claim, the plaintiff must show that the alleged monopolist has engaged in improper exclusionary conduct. *See Kodak*, 504 U.S. at 482-83; *Aspen Skiing Co.* v. *Aspen Highlands Skiing Corp.*, 472 U.S. 585, 600-05 (1985); *Barry Wright Corp.* v. *ITT Grinnell Corp.*, 724 F.2d 227, 230 (1st Cir. 1983).

The improper conduct identified by SMS is the inclusion of a three-year warranty on new equipment in the purchase package.[8] But a warranty has obvious virtue as a tool of competition, and the commercial justification for its use is compelling. Indeed, people ordinarily associate warranties with consumer welfare and highly competitive markets.

To avoid the presumption that DEC's warranty is no more than a legitimate sales tool, SMS points to two internal documents which it claims show that DEC intended to use the warranty as a device to capture the totality of the services aftermarket. These documents appear to be a part of an ongoing series of correspondence between DEC functionaries relative to the launching of the Alpha product line. One document makes mention of the warranties having "100% penetration with all product sales" and the other makes a similar point. Read in context, neither document so much as hints at an intent to suffocate the aftermarket. The mere fact that the terms "warranty," "penetration," and "100%" appear in a single writing does not signal an improper attempt to distort market forces.

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[8] SMS claims that the warranty also indirectly causes further damage to ISOs because of the phenomenon of "one stop" servicing. The idea is that companies that have several DEC machines will opt to go with DEC services after purchasing a new (warranty-bearing) computer because they do not want to deal with the confusion resulting from having several different service providers. As with much else in this case, concrete evidence that this supposed behavioral pattern exists, or that it is in any way significant, is wanting.

In the last analysis, SMS's monopoly power hypothesis defies common sense. If the three-year warranty is the only means toward monopolization, it will, under the assumptions that SMS adopts, prove to be a remarkably ineffective tool. SMS has taken the position that the warranty actually represents a loss to DEC because, all things being equal, DEC can make more money providing services than it can offering warranties. *See supra* note 5. If this is true, SMS's argument takes on the flavor of the predatory pricing cases and, therefore, must afford some basis for a belief that DEC can recoup these losses at some point in the future in order to make the enterprise worthwhile.

But DEC has placed no restriction on the aftermarket for service of its products. Parts are available to all market participants, and there is no indication in the record either that there are restrictions on their availability or that such a policy is even being contemplated. Meanwhile, ISOs are free to service all DEC computers, including those that are under warranty, both during the warranty period and after its expiration. On these facts, it seems highly unlikely that DEC will recoup the sums that SMS says that it foregoes when it offers the warranties in the first place. All of this indicates that the more likely explanation for the warranty relates to its efficiency as a means of growing market share in the primary market. In any event, sacrifice now/recoup later claims do not necessarily bespeak monopolistic behavior, *see, e.g., Barry Wright*, 724 F.2d at 231-36, and we believe that this dimension of SMS's logic is yet another element that distances its case from *Kodak* while simultaneously bringing it within the orbit of *Matsushita Elec. Indus. Co.* v.

Zenith Radio Corp., 475 U.S. 574, 587 (1986) (noting that evidence must be even more persuasive to stave off summary judgment when the theory set forth by the party opposing the motion is implausible).

That SMS may have lost business as a result of DEC's policy is not, in and of itself, a concern of the antitrust laws. Antitrust law is designed to protect competition, not competitors. *See Spectrum Sports, Inc.* v. *McQuillan*, 506 U.S. 447, 458-59 (1993). If there is no objective indication of harm to competition, we cannot stifle a firm's ability to compete in the primary market just because some of its aftermarket competitors complain that they have lost business as a result. After all, such harm frequently occurs due to the specialized and dependent nature of the investment made by aftermarket firms rather than as the anticompetitive exercise of market power by manufacturers. *See* 3A Areeda & Hovenkamp, *supra*, ¶ 762, at 65-66 (explaining the phenomenon in the context of self-distribution decisions made by manufacturers).

VI

We need go no further. The *Kodak* Court resorted to economic theory in order to highlight the possibility that, under the notably sinister circumstances of the case (evidence of supracompetitive prices in the aftermarket, price discrimination favoring certain consumers, and no resulting change in sales in the primary market), information deficits and switching costs better explained the available market data than did the defendant's glib assertion that the aftermarket is never independent of the foremarket.

Theory is powerful when it explains reality. But when evidence for the trumpeted reality is lacking, the theory is of no practical value. Here, the record contains no significantly probative evidence that DEC is engaged in sinister practices or otherwise suffocating competition, and, hence, theoretical possibilities alone are inadequate to block the swing of the summary judgment ax.

Affirmed.

UNITED STATES DISTRICT COURT
DISTRICT OF MASSACHUSETTS

SMS SYSTEMS MAINTENANCE SERVICES, INC., Plaintiff v. DIGITAL EQUIPMENT CORP., Defendant.	CIVIL ACTION NO.: 96-10429-EFH

MEMORANDUM AND ORDER

July 30, 1998

HARRINGTON, D.J.

Plaintiff SMS Systems Maintenance Services, Inc. ("SMS") has charged Defendant Digital Equipment Company ("Digital") with attempting to monopolize the market for repair and maintenance of Digital computers, in violation of the Sherman Act, 15 U.S.C. § 2. SMS has also alleged state law claims for Tortious Interference with Prospective Contractual Relations (Count II), Tortious Interference with Contractual Relations (Count III), Unfair and Deceptive Trade Practices in violation of Mass.Gen.L. ch. 93A, § 11 (Count IV), and Injunctive Relief (Count Five).

The case arises out of Defendant Digital's decision to offer extended warranties covering maintenance and service on certain lines of Digital computers. Digital manufactures and sells a variety of computer lines and computer products. Digital also provides maintenance and service on its computer products. Prior to 1994, Digital provided many customers with maintenance service under an optional one-year warranty offered with the computer products it sold. In 1994, Digital amended its warranty policy on certain computers. In order to promote sales of its new Alpha computers, Digital offered an extended three-year warranty on those computers. Digital embedded the costs associated with the warranty into the price of the Alpha computers. Digital also made the three-year warranty mandatory, refusing to offer a reduction in price to customers who asked to purchase the computer equipment without the extended warranty. In 1995, Digital broadened the extended warranty program by offering a mandatory three-year warranty on certain VAX computer products.

Plaintiff SMS is an independent service organization which specializes in the repair and maintenance of Digital computers. SMS provides maintenance and service to corporations and agencies that own Digital computers. SMS contends that Digital's new mandatory extended warranty violates federal antitrust law by making it difficult for SMS and other independent service organizations to compete with Digital in the market for service and maintenance of Digital computers.

SMS' theory of liability on its antitrust claim is that Digital violated Section 2 of the Sherman Act, 15 U.S.C. § 2, by attempting to monopolize the market for servicing

and maintaining Digital computers. The elements of monopolization under Section 2 are well settled:

> The offense of monopoly under § 2 of the Sherman Act has two elements: (1) the possession of monopoly power in the relevant market and (2) the willful acquisition or maintenance of that power.

Eastman Kodak Co. v. Image Technical Services, Inc., 504 U.S. 451, 480 (1992).

The key issue in dispute in this case is the definition of the relevant market. SMS asserts that the relevant market is the derivative aftermarket for servicing and maintaining Digital computers. Digital has approximately 91 percent of this narrow service market. If this service market is the relevant market, SMS will have satisfied the "monopoly power" element of its Section 2 claim. In support of its position that the aftermarket is the relevant market, SMS relies on the Supreme Court decision in *Kodak*. *Id.* In *Kodak*, the Supreme Court held that, in certain circumstances, the derivative aftermarket for services could be the relevant market for antitrust purposes. *Id.* at 476-477.

Defendant Digital opposes this narrow definition of the relevant market. Digital argues that, as a matter of law, the relevant market for antitrust purposes is the primary market for the sale of computer equipment. Digital accounts for less than 30 percent of the computer equipment market. If the computer equipment market is determined to be the relevant market, SMS has conceded that it will be unable to satisfy the monopoly power

requirement for a claim under Section 2.[1] In support of its position that the primary equipment market is the relevant market, Digital distinguishes *Kodak* from the case at bar and cites a number of circuit court decisions which have rejected attempts by plaintiffs "to shoehorn their allegations into [the] *Kodak* 'derivative aftermarket' model." *Lee v. Life Ins. Co. of North America*, 23 F.3d 14, 18 (1st Cir. 1994). The Court is persuaded by the defendant's argument.

Kodak is distinguishable from the case at bar because in *Kodak* the manufacturer announced a restrictive change in its replacement parts policy which had a direct impact on "locked in" customers who had already purchased Kodak copiers. *Kodak*, 504 U.S. at 476-477. Kodak's changed policy was to limit the availability of replacement parts for copiers by selling replacement parts "only to buyers of Kodak equipment who use Kodak service or repair on their machines." *Id.* at 458. This new policy effectively limited the service and maintenance options available to customers who had purchased Kodak copiers in the past. The instant case is inapposite. Digital's new extended warranty did not limit the options available to customers who had purchased Digital computers in the past. In fact, the new warranty had no direct impact upon Digital's relationship with customers who had purchased

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[1] "Thirty percent of the computer market is not enough to confer substantial market power unless there are high barriers to competition. Rapid and continuing entry into the computer business, and the ease with which existing firms increase output, dispel any concerns about barriers to entry." *Digital Equipment Corp. v. Uniq Digital Technologies, Inc.*, 73 F.3d 756, 761 (7th Cir. 1996).

Digital computer equipment prior to the implementation of the new warranty policy. Since Digital's new warranty policy affected only future customers, there is no *Kodak*-type "lock-in" in this case.

Moreover, in *Kodak*, the Supreme Court itself acknowledged that the bundling of products and services promotes competition and does not violate the antitrust laws.[2] In particular, the court stated that:

> It is undisputed that competition is enhanced when a firm is able to offer various marketing options, including bundling of support and maintenance service with the sale of equipment. Nor do such actions run afoul of the antitrust laws.

Kodak, 504 U.S. at 478-479 (*citing Jefferson Parish Hosp. Dist. No. 2 v. Hyde*, 466 U.S. 2, 12 (1984)).

All of the circuit courts which have addressed the issue agree with this language in *Kodak*. In *Lee v. Life Ins. Co. of North America*, 23 F.3d 14 (1st Cir.1994), the Court of Appeals for the First Circuit rejected plaintiffs' attempt to assert that the relevant market for an antitrust claim was the narrow aftermarket for health care services for undergraduate students enrolled at the University of Rhode Island. Instead, the Court ruled that the relevant market

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[2] In 1992, both Compaq and IBM, two of Digital's competitors in the market for the sale of computer equipment, began to offer three-year warranties on certain computers. Compaq's warranty was mandatory and the costs associated with the warranty were included in the price of the computer equipment.

for antitrust purposes was the primary (university education) market. *Id.* at 20. The critical question according to the Court was whether the relevant policy and pricing information was available to customers before they made the initial purchase. In *Lee*, the Court of Appeals analyzed *Kodak* and noted that:

> Had previous customers known, at the time they bought their Kodak copiers, that Kodak would implement its restrictive parts-servicing policy, Kodak's "market power," i.e. its leverage to induce customers to purchase Kodak servicing could only have been as significant as its AEP [appreciable economic power] in the copier market.

Id.

The determinative factor for the Court of Appeals in *Lee* was that, unlike the customers in *Kodak*, all of the potential customers in *Lee* knew in advance about the allegedly restrictive health care services policy prior to purchasing the primary product; university education. The Court of Appeals stated:

> In the instant case, however, students know before their matriculation that they are buying a URI 'package' that includes at least two 'tied' products – a URI education and on-campus health care service and insurances. As appellant failed to assert a colorable claim that URI had [market power] in the primary (university education) market, no *Kodak*-type 'lock-in' could have occurred in subsequent semesters.

Id.

The Court of Appeals for the Seventh Circuit used the same reasoning in affirming summary judgment for Digital which defended an antitrust counterclaim in *Digital Equipment Corporation v. Uniq Digital Technologies*, 73 F.3d 756 (7th Cir. 1996). In that case, Uniq's counterclaim alleged that Digital was attempting to monopolize the market for the sale of operating systems used with Digital computers by bundling its operating system with all Digital computers it sold. The Court of Appeals for the Seventh Circuit held that since purchasers knew in advance about the bundling, the relevant market for antitrust purposes was the primary equipment market, not the derivative aftermarket. *Id.* at 761-763. Interestingly, in dicta, the *Digital* Court directly addressed the issue faced by the Court in this case:

> Suppose DEC [Digital] includes extensive manuals, or "free" support services, or operating systems, that consumers do not want . . . "Free" tech support is not free; customers pay for it in the price of the product, and a marginal cost of zero for calling means that it will be overused, and hence can add quite a bit to the price of a computer or a software package. Instead of paying DEC for something they do not want, customers will turn elsewhere – for other firms can increase their profit by satisfying users' demands. . . . In a competitive market, pigheaded refusal to satisfy customers' preferences, or an attempt to charge for unwanted items, does not lead to monopoly prices; instead it leads to ruin as rivals step in to take the business. Preserving that market process, rather

> than regulating through the judicial system, is the objective of the antitrust laws.

Id. at 762.

The Court of Appeals for the Sixth Circuit agrees with this reasoning. In *PSI Repair Services, Inc. v. Honeywell,* 104 F.3d 811 (6th Cir. 1997), the Court of Appeals ruled that a manufacturer was free to bundle products and service so long as the relevant pricing information was available to customers prior to the sale. *Id.* at 820. The Court specifically held that an antitrust plaintiff cannot succeed on a *Kodak*-type theory when the defendant has been otherwise forthcoming about its pricing structure and service policies and has not changed its policies so as to affect the service options available to prior purchasers. *Id.* The Court of Appeals ruled, as a matter of law, that where the allegedly restrictive policy did not affect customers who had already purchased the primary product, the relevant market was the primary equipment market, not the derivative aftermarket. *Id.* The Third Circuit and Fifth Circuit have also accepted this interpretation of *Kodak. See Queen City Pizza, Inc. v. Domino's Pizza, Inc.,* 124 F.3d 430 (3d Cir. 1997); *United Farmers Agents Ass'n v. Farmers Ins. Exch.,* 89 F.3d 233 (5th Cir. 1996).

The Court is persuaded by this great weight of authority. Since Digital's warranty policy was prospective and since information about Digital's mandatory three-year warranty has always been available to potential customers in advance, there is no *Kodak*-type lock-in in this case. The relevant market for antitrust purposes is the primary equipment market not the derivative aftermarket for service and maintenance of Digital computers.

Since Digital does not have monopoly power in the market for sale of computer equipment, SMS has failed to meet an essential element of its Section 2 antitrust claim.

The Court's determination that SMS has failed to meet its burden under Section 2 of the Sherman Act is not necessarily dispositive. During oral argument, the plaintiff articulated for the first time a supplemental tying theory of liability, alleging that the mandatory nature of the extended warranty constituted an illegal tying. Although plaintiff claimed that it had not filed and was not making a tying claim, the issue was raised at oral argument. Therefore, the Court will address the tying issue.

"A tying arrangement is an agreement by a party to sell one product but only on the condition that the buyer also purchases a different (or tied) product." *Kodak*, 504 U.S. at 461. Such an arrangement is violative of Section 1 of the Sherman Act, 15 U.S.C. § 1, if the seller has appreciable economic power in the tying market and if the arrangement affects a substantial volume of commerce in the tied market. *Id.*

In the instant case, there has been no illegal tying. The tying market in these circumstances is the computer equipment market. As noted above, Digital does not have appreciable economic power in that market. Hence, Digital's policy of tying a mandatory warranty with its equipment cannot be found in violation of Section 1 of the Sherman Act.

For the foregoing reasons, the Court grants summary judgment for the defendant on the plaintiff's federal antitrust claim.

In the absence of any federal question, this Court declines to exercise supplemental jurisdiction over the remaining state law claims involving two Massachusetts corporations. All state law claims are dismissed without prejudice.

SO ORDERED.

/s/ Edward F. Harrington
EDWARD F. HARRINGTON
United States District Judge

UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

No. 99-1009

SMS SYSTEMS MAINTENANCE SERVICES, INC.,
Plaintiff, Appellant,

v.

DIGITAL EQUIPMENT, CORP.,
Defendant, Appellee.

Before

Torruella, *Chief Judge*,
Campbell, *Senior Circuit Judge*,
and Selya, *Circuit Judge*.

ORDER OF COURT

Entered: September 13, 1999

Upon consideration of plaintiff-appellant's petition for rehearing,

It is ordered that the petition for rehearing be denied.

By the Court:

Phoebe Morse, Clerk.

By /s/ Janice M. O'Neil
Chief Deputy Clerk.

[cc: Messrs: Kehoe, Katz, Hudspeth, Hassi, Remis, Downs, Fiotto and Ms. Fiero]

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§ 2 Monopolizing trade a felony; penalty

Every person who shall monopolize, or attempt to monopolize, or combine or conspire with any other person or persons, to monopolize any part of the trade or commerce among the several States, or with foreign nations, shall be deemed guilty of a felony, and, on conviction thereof, shall be punished by a fine not exceeding $10,000,000 if a corporation, or, if any other person, $350,000, or by imprisonment not exceeding three years, or by both said punishments, in the discretion of the court.

(As amended Nov. 16, 1990, Pub.L. 101-588, § 4(b), 104 Stat. 2880.)